FAIR POLITICAL PRACTICES COMMISSION
Memorandum

To: Chairman Randolph, Commissioners Blair, Downey, Karlan and Knox

From: Kenneth L. Glick, Commission Counsel
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Subject: Pre-Notice Discussion of "Has Reason to Know/Reasonable Diligence" Regulation (Re-Adoption of Regulation 18700.1)

Date: April 28, 2004

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I. EXECUTIVE SUMMARY

This regulatory project is in response to the Commission's request to examine whether public officials are unnecessarily disqualifying themselves from certain governmental decisions under sections 87100 and 87103, the conflict-of-interest provisions of the Political Reform Act ("Act").[1] Staff has examined whether a new regulation clarifying section 87100's "has reason to know" [2] language would provide public officials with greater certainty as to when the Act requires that they disqualify themselves from a governmental decision within their agency.

The staff held an "Interested Persons" meeting on March 24, 2004, which was attended in person or by telephone by a total of 15 individuals, in addition to Commission staff.[3] Staff then turned its attention to drafting possible regulatory language for the purpose of discussing concepts and identifying issues. Initially, staff presents for discussion new regulation 18700.1 to clarify the "has reason to know" language of section 87100. The approach under this new regulation implicitly recognizes that what an official "has reason to know" depends on the totality of the circumstances surrounding the official and the governmental decision. It is the public official's knowledge of these circumstances, including a factual inquiry when certain knowledge is lacking, which provides the official with a reason to know whether he or

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[1] All references are to the Government Code sections 81000 – 91014 unless otherwise noted. All regulatory citations are to Commission regulations at Title 2, sections 18109 – 18997, of the California Code of Regulations.

[2] This is a situation in which a public official has *no actual knowledge* as to whether a governmental decision of his or her agency will have a reasonably foreseeable material financial effect on the official's economic interests.

[3] This included representatives from the California State Treasurer's Office, California State Food and Drug Administration, California Association of Realtors, San Diego City Ethics Commission, Los Angeles County Board of Supervisors, Los Angeles Transit Authority, several local law firms, and three law students from the University of California's Hastings College of the Law.

she has a financial interest in a decision. Thus, in subdivision (a) the regulation first establishes that a public official has a duty of "reasonable" diligence in determining whether he or she "has reason to know" of a potential conflict of interest. Second, in subdivisions (b) and (c) the regulation describes mandatory and permissive steps, which, when taken by an official, could demonstrate his or her exercise of the required diligence. Third, in subdivision (d) the regulation provides that a public official's duty to comply with sections 87100 and 87103 is non-delegable.

The issues on which the staff seeks guidance are summarized below:

- Does the Commission wish to continue with this regulatory undertaking? If so,

- The draft regulation at subdivision (a) establishes a legal standard for public officials to follow in determining whether they have a "reason to know" of a conflict of interest. Is this an appropriate standard?

- Should the standard described in subdivision (a) apply to all of the relevant steps of the conflict-of-interest analysis (Steps 3-6) described in regulation 18700(b)?

- The draft regulation, at paragraphs 18700.1(b) and (c), respectively, lists mandatory and permissive criteria which, if followed, would demonstrate that a public official exercised reasonable diligence in deciding whether the official had reason to know of a financial interest in a governmental decision. Are these appropriate criteria?

- Should a draft regulation provide that a public official's duty to comply with sections 87100 and 87103 is non-delegable?

- Should a regulation also describe specific circumstances in which a public official will be deemed to have reason to know that he or she has a financial interest in a governmental decision?

II. ANALYSIS

A. Overview

1."Know or Has Reason to Know" as an Element of a Conflict of Interest

Two sections of the Act together provide the elements which comprise a disqualifying conflict of interest. Section 87100 provides the basic conflict-of-interest rule:

> "No public official at any level of state or local government shall make, participate in making or in any way attempt to use his

> official position to influence a governmental decision in which he *knows or has reason* to know he has a financial interest." [Emphasis added.]

Section 87103 defines a "financial interest" as a reasonably foreseeable material financial effect on one or more of the official's economic interests, which effect is distinguishable from the effect upon the public generally.

A conflict of interest is based on the following questions:

1. Is the individual a "public official"?

2. Will the public official be making, participating in making, or influencing a governmental decision?

3. What are the public official's economic interests?

4. Will one or more of those economic interests be directly or indirectly involved in the governmental decision?

5. Based on the applicable materiality standard, is the financial effect of the governmental decision on those economic interests "material"?

6. Is the material financial effect of the governmental decision on the public official's economic interests reasonably foreseeable?

If the answers to all of the above are yes, then the public official will have a conflict of interest with respect to the governmental decision of his or her agency unless the following two questions can be answered in the affirmative:

7. Does the "public generally" exception apply?

8. Is the public official "legally required" to participate in a governmental decision?

The Commission's standard eight-step conflict-of-interest analysis is outlined in regulation 18700.[4] It currently does not specifically incorporate a separate step at which an official is to consider whether he or she "knows or has reason to know" that he or she has a financial interest in a decision.

[4] If the Commission wishes to adopt a regulation describing an official's duty to exercise reasonable diligence and various criteria under that duty, conforming changes will likely be required to regulation 18700 in its description of the eight-step standard conflict-of-interest analysis.

While actual knowledge of the existence of each of the elements comprising a financial interest is not at issue here, there is no regulatory guidance within the eight-step analysis describing when a public official "has reason to know" that a particular decision will have a reasonably foreseeable material financial effect upon one or more of his or her economic interests.

In other words, if a public official cannot answer "yes" or "no" to the question of whether a decision will have a reasonably foreseeable material financial effect on an economic interest (i.e., actual knowledge), the next question is whether it is plausible that the decision might have such an effect (i.e., has reason to know). If the answer to the latter is in the affirmative, section 87100 of the Act may require the official to disqualify himself or herself from the decision. This latter analytical step is not specifically described under the regulations, but presumably is being taken by public officials as they seek to meet the "knows or has reason to know" standard of section 87100.

2. "Knows or Has Reason to Know" Language and Enforcement of the Act

The inclusion of the statutory "knows or has reason to know" as a chargeable element of a conflict-of-interest violation is illustrated by the enforcement decision, *In re Smoley* (1989) FPPC No. SI-86/370 ("*Smoley*").[5] In 1989, the Commission approved a Stipulation, Decision and Order ("Stipulation") in which Sandra Smoley, then a member of the Sacramento County Board of Supervisors and Sacramento County Sanitation District Board, pled to eight counts of violating sections 87100 and 87103 of the Act. The 10-page charging document attached as an exhibit to the Stipulation, contained a statement of the law, stating in relevant part:

> "The Act's conflict of interest provisions prohibit a public official from making a governmental decision in which she knows or has reason to know she has a financial interest. (Section 87100.)"

This exhibit also set forth findings of fact with respect to each violation. Significantly, these findings of fact stated with respect to each violation: a) Mrs. Smoley knew that a person involved in that particular governmental decision was either directly or indirectly a source of income to her at the time she made a governmental decision; and b) at the time the governmental decision was made, it was reasonably foreseeable to Ms. Smoley that the decision would have a material financial effect on the source of income.

When discussing factors in aggravation, this exhibit describes that Ms. Smoley sought and received (incorrect) advice from a private attorney that, because of the terms of her pre-nuptial agreement, certain of her pecuniary interests based on her spouse's

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[5] Neither the Act nor Commission regulations explicitly require that a Commission enforcement decision be given precedential value. This means the Commission is not obligated to follow the interpretations or rulings of an enforcement decision (including *Smoley*) in subsequent proceedings involving other parties. In any event, the *Smoley* decision is a settlement; as a matter of law settlements are not precedential.

pre-marital finances were not "economic interests" to her. The related discussion applies the "knows or has reason to know" standard in this context:

> "Mrs. Smoley should not have relied on Mr. Bell's advice and should have questioned that advice. The written advice of her attorney was based on certain assumptions, which were stated in his letter to her. These assumptions were contrary to the terms of the pre-nuptial agreement. Mrs. Smoley was aware of the terms of the agreement and *knew, or should have known*, that the advice of her attorney failed to consider essential elements of her pre-nuptial agreement." [Emphasis added.]

From this, one can adduce that under the "knows or has reason to know" language of section 87100, conditions can arise under which a public official, although having no actual knowledge that he or she has a financial interest in a governmental decision, will nevertheless have knowledge of other facts which, when taken together, imply constructive knowledge on the part of the official that he or she has such financial interest. When such constructive knowledge exists, the official is under a duty to take further steps to disprove the existence of the financial interest before participating in the governmental decision.

Thus, the "knows or has reason to know" element of section 87100 was applied in *Smoley* both to establish a violation of the Act in the first instance, and also to impose a duty[6] on the official for which the failure to perform constituted an aggravating factor when determining the appropriate penalty.

3. Written Staff Advice

Public officials have sought written advice over the years regarding the "has reason to know" language of section 87100. Principally, these requests question whether, or under what circumstances, a public official not having actual knowledge of a financial interest in a decision has a duty, under the "has reason to know" language to conduct an inquiry to determine the existence of a financial interest. To a lesser extent, these officials have sought advice as to whether that duty may be delegated to third parties. Staff advice on these and related points is described in the summary below.

Typically, advice letters analyzing the "knows or has reason to know" language do so when the relevant economic interest is a source of income, or to a lesser frequency, real property. This source of income may be a business entity paying wages to the official, a client or customer of the official's sole proprietorship, or the more complex situation involving sources of income to a spouse or business entity owned by the official's spouse. Advice is sought in these circumstances regarding the official's duty to

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[6] Contrast this with the advice given in *Price* Advice Letter, No. A-85-165, and its progeny, discussed in section 3 of this memorandum.

become informed, in the absence of actual knowledge, whether the governmental decision is one in which the official has a financial interest.

In addition, advice has been given on whether schemes crafted by officials involving a third-party when deciding whether the official has reason to know of a financial interest involved in a particular governmental decision, meets the "knows or has reason to know" requirement.

Advice received: The *Price* Advice Letter, No. A-85-165 is the most often-cited letter for an analysis of whether a public official "knows or has reason to know" that a governmental decision will affect the official's financial interests.[7] *Price* states in this regard:

> "Sections 87100 and 87103 also require disqualification if an official has reason to know that it is reasonably foreseeable that a decision will materially affect a source of his or her income. As a general rule, an official 'has reason to know' that a decision will affect a source of income whenever a reasonable person, under the same circumstances, would be likely to know the identity of the source of income and would be aware of the decision's probable impact on that source. An official engaged in a business which has numerous customers or clients is not ordinarily required to take affirmative steps to familiarize himself or herself with the identities of all sources of income to the business, nor to consult his or her sources of income to determine whether a decision will affect them."[8] [Emphasis in original.]

In *Levy* Advice Letter, No. A-87-222 the public official was advised that "[t]he standard for knowing if you have a financial interest in a decision before the board is if: 'a reasonable person, under the same circumstances would be likely to know the identity of the source of income and would be aware of the decision's probable impact on that source.' " Since the economic interest was a large department store serving more than 275,000 customers, the official was further advised that she was not required to ascertain who has paid the store a $250 (the then-applicable threshold to determine a source of income) prorated amount in the preceding 12 months.

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[7] *Price* has been cited in 13 advice letters since 1990. *Price*, however, merely repeats verbatim the analysis provided three years earlier in the *Cohen* Advice Letter, No. A-82-197. *Cohen* appears to be the first time advice was given on whether the "knows or has reason to know" language of section 87100 imposes a duty on a public official to inform himself or herself as to the identity of sources of income to either a spouse of a public official or a business entity in which the official has a 10% or greater ownership interest.

[8] Contrast this language with the *Smoley* enforcement decision, above. *Smoley* reasoned that because of the "has reason to know" requirement, under the facts of that case the public official had knowledge of certain facts which gave rise to a duty to question the advice of her privately-retained counsel. The official's failure to question the advice of counsel was recited as an aggravating factor with respect to the amount of the penalty assessed.

In the *Lucas* Advice Letter, No. A-98-109, the public official specifically requested advice on what exactly was required under the "has reason to know" standard of section 87100. This letter summarized past advice on this topic *(Price*, *supra*, *Elam* Advice Letter, No. I-89-467; *Levy*, *supra*; *Vadon* Advice Letter, No. A-97-502; and *Weedman* Advice Letter, No. I-90-759) into the following:

- A public official has reason to know that a decision will affect a source of income whenever a reasonable person, under the same circumstances, would: (a) be likely to know the identity of the source of income, and (b) would be aware of the decision's probable impact on that source of income; and

- Once step one is met, the public official must make a good faith effort to determine if it is reasonably foreseeable that the decision will have a material financial effect on the source of income.

In that instance, the official was advised that she was not under an affirmative duty to inform herself of the identity of the bank's customers. (Her husband was an employee of the bank.) This reflected the advice in the *Burnham* Advice Letter, No. A-82-039 where, in an analogous situation, the public official was advised that she was not under an obligation to inform herself as to the identity of the bank's customers. Nevertheless, in certain circumstances past advice recognizes that the "has reason to know" requirement does not allow a public official to remain willfully ignorant as to the identity of his or her sources of income.

Officials lacking actual knowledge have sought to comply with the Act in these situations by involving third-party decisionmakers or investigators to determine whether they (the officials) have reason to know a decision involves a financial interest. For example, in the *Christiansen* Advice Letter, No. I-87-019, the public official's spouse was a 50% partner in an accounting partnership. Clients paying the partnership $1,000 or more over the relevant 12-month period were potentially disqualifying economic interests to the public official. The official's spouse was unwilling to disclose the identity of these clients to the official, citing professional confidentiality concerns. Thus, the official questioned whether the "knows or has reason to know" requirement would be met if the following steps were taken:

- The city staff would prepare in advance a list of applicants expected to appear on the next city council agenda, together with the subject matter of the items;

- This list would be reviewed with due diligence by staff of the spouse's partnership to identify any sources of income of $1,000 or more which were applicants on the supplied list. If so, the official would be advised of that fact; and

- The official would disqualify herself with respect to any agenda item in which the applicant was a client providing the partnership with income of $1,000 or more, as provided to her in step 2, above.

The advice letter concluded that this was a "good approach" and would be evidence of the official's good faith effort to comply with the disqualification requirements of the Act. The official was warned, however, that her responsibility for disclosure and disqualification could not be transferred to a staff person in her spouse's firm. If the official became aware of the firm's clients through other means, such as during a social function or during conversations with her spouse, the official would also know or have reason to know of her financial interest in a particular decision.[9]

B. Specific Decision Points

1. Need for Regulatory Language

The threshold question in this project is whether any new regulatory language is needed in order to make it easier for a public official, under the "has reason to know" language of section 87100, to make the appropriate decision whether to disqualify himself or herself from a particular governmental decision. During Phase 2 of the Conflicts of Interest Regulations Improvement Project (Project C), some public interest was expressed in the Commission's adopting regulatory language which would allow a public official to satisfy the "has reason to know" language of section 87100. Proposed standards were offered by the California Association of Realtors and the City of Los Angeles. Since that time, the reason for the public's interest (originally a question of what is "reasonably foreseeable") has shifted, but the interest still remains. The consensus at the interested persons meeting held by staff in March 2004,[10] was that a regulation clarifying this language could prove helpful, as long as its purpose was to minimize unnecessary, or precautionary, disqualification by public officials otherwise entitled under the Act to participate in their agency's decisions.

While some perceive a need for further regulation to explain section 87100, the "has reason to know" language of that section is inherently subjective and for that reason, difficult to define. This language imputes constructive knowledge to a public official, which is something typically defined at law by some form of a "reasonable person" standard. Drafting an appropriate reasonable person (i.e., "reasonable" or "due" diligence) standard for this section of the Act will not answer every official's questions with respect to applying section 87100. Nevertheless, efforts by lawmakers and judicial precedents with respect to tort law demonstrate that adopting standards of diligence to lessen the subjective nature of a constructive knowledge statute (in this instance, section

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[9] This advice letter also incorrectly stated in part that a spouse's reluctance to disclose sources of income might excuse a public official from his or her *reporting obligations* regarding a community property interest in that income. In June of 1995, the *Christiansen* advice letter was overruled on this point.

[10] For a description of the attendees, see footnote 3, above.

87100) could have a positive benefit on those subject to the Act's conflict-of-interest provisions.

Staff Recommendation: At this point, staff believes that some regulatory language would be helpful to public officials. First, it would codify (or clarify) the legal standard, i.e., "reasonably prudent public official" standard, which can be implied under section 87100. Second it would codify, in part, past Commission advice regarding the duty owed by public officials. However, as discussed below, the staff does not believe that development of regulatory language defining the specific circumstances in which a public official has reason to know of a financial interest in a decision is feasible.

2. Scope of the Regulation

A reasonable (or due) diligence[11] regulation would apply only when a public official has no actual knowledge that he or she has a financial interest in a particular governmental decision. The general rule in such situations would be that a public official shall exercise reasonable diligence in order to determine whether the official has a financial interest in the governmental decision. Potentially, from that point, the regulation could potentially become more specific. Thus, a draft regulation might:

> First, articulate the steps, which when taken by a public official, constitute an exercise of "reasonable diligence;"
>
> Second, provide a short illustrative list of specific circumstances (examples are shown below) in which a public official is deemed to have reason to know that a governmental decision is one in which the official has a financial interest; and, possibly,
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> Third, describe the effects of a public official's compliance with the "reasonable diligence" standard. This effect could be realized at the point a finding of a violation of the Act is made, when assessing mitigating or aggravating factors for purposes of assessing a penalty, or both.

The draft regulation addresses only the first objective. The draft regulation lays out the general rule and supplies mandatory and permissive steps which constitute an exercise of reasonable diligence.

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[11] When speaking as to the duty of care exercised by fiduciaries, the law typically uses the expression "due diligence." Section 84213 of the Act speaks to a committee treasurer's obligation to use all "reasonable diligence" in the preparation of a committee's campaign statements. Otherwise, the Act is silent with respect to a standard of diligence. Whether "due diligence" is a different standard than "reasonable diligence" is something beyond the scope of this memorandum. For consistency sake, "reasonable diligence" will be used hereafter to indicate the duty owing by an official under section 87100 of the Act.

3. Proposed Regulatory Language

a. <u>Reasonable diligence (subdivisions (a) – (c))</u>. Defining a standard of "reasonable diligence" under section 87100 includes setting out a general rule and then describing reasonable steps an official could take in order to demonstrate the diligence required under the general rule. Implicit with this general rule is recognizing that under section 87100, a public official may not remain willfully ignorant of the involvement of his or her financial interests in a governmental decision. When the official has knowledge of facts which a reasonably prudent public official, in similar circumstances, would construe as providing constructive knowledge that he or she has a financial interest in the decision, the official is under a duty to take further steps – exercise reasonable diligence – to disprove the existence of a financial interest before participating in the governmental decision. This is set forth in subdivision (a) of the draft regulation.[12]

The reasonably prudent public official standard is intended to suggest a higher standard of diligence than that exercised by an individual who is not a public official. When a special relationship exists between parties, or the subject matter of an action carries a special risk, the law generally imposes a higher duty of care. (*Hoff v. Vacaville United School District* (1998) 19 Cal.4th 925 (parent and child); *Carlin v. Superior Court* (1996) 13 Cal.4th 1104 (manufacturer of pharmaceuticals).) A public official can be said to enjoy a special relationship with the public, inasmuch as the official is entrusted with the public's business. (*Nussbaum v. Weeks* (1989) 214 Cal. Ap.3d 1589 at 1597, "Nussbaum relies on the truism that a public office is a public trust. . . . [citation omitted] 'The theory of the law is that a councilman or other officer of a city sustains the same fiduciary relationship toward the citizens of his community that a trustee bears to his *cestui que trust*, and should therefore act with the utmost good faith.'") (See also *People v. Carr* (1958) 163 Cal.App.2d 568 at 577, "…the district attorney as a representative of the People is . . . bound by a somewhat higher duty of fairness than is the ordinary practitioner in a court of law.") Thus, the draft regulation incorporates language to reflect the higher duty owing, when compared to an individual not entrusted with the public's business.

In addition, the proposed regulatory language of subdivision (b)(2) incorporates into a standard of reasonable diligence a review of applicable provisions of the Act and the Commission's regulations, when undertaking the standard eight-step conflict-of-interest analysis. Based on past advice requests, a great deal of the public's uncertainty with respect to the "has reason to know" language has to do with a duty to gather information when a public official lacks the information necessary to decide whether a particular step of the eight-step conflict-of-interest analysis is met. Thus, the draft regulation addresses when reasonable diligence will require a public official to undertake an investigation:

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[12] The proposed regulatory language is modeled, in part, after section 84213 and regulation 18316.5.

> "Should a public official lack information sufficient to complete one or more steps of the conflict-of-interest analysis described in 2 Cal. Code Regs. section 18700(b), the public official shall undertake a factual inquiry of such scope and effort as a reasonably prudent public official of like office and in similar circumstances would undertake when facing the same or a similar decision." (Reg. 18700.1(a).)

This language is a variation, unique to the Act, of the classic "reasonable person" standard long used in negligence and other areas of the law to define the obligations of one who is under a legal duty. Just as judicial precedents or legislative enactments, in some instances, lend specificity to this general language, the draft regulation proposes certain mandatory steps which would be required by an exercise of reasonable diligence.

This review and analysis, combined with a review of the materials of the official's agency (as provided in subdivision (b)(1) of the draft regulation) would be mandatory.

In addition, at subdivision (c), the draft regulation sets forth other steps which, although not mandatory, are available to a public official in this context as an exercise of reasonable diligence. These actions include:

- A review of any relevant Commission materials;

- Obtaining a Commission opinion or Commission written advice; and

- Reviewing information in the possession or under the control of a public official or members of his or her immediate family, or any of their representatives or agents, which is relevant to whether the decision will have a reasonably foreseeable material financial effect on one or more of the official's economic interests.

From a policy perspective, the Commission has the choice of determining whether the exercise of reasonable diligence should involve any mandatory actions, as opposed to permissive. In other words, to exercise reasonable diligence, must a public official, at a minimum, accomplish one or more of these steps, or may the public official choose other means to exercise reasonable diligence?

The downside of treating these steps as mandatory is that it is difficult to accurately state a "one size fits all" approach to defining what is inherently a subjective standard (i.e., "reasonable"), particularly given the variety and number of potential decisions for which the standard will be applied. On the other hand, without some firm guidance, the test of what constitutes "reasonable diligence" could lapse into such subjectivity that it would be impossible to interpret.

What may be critical here is the scope of what the Commission wishes to pursue with respect to this project. For example, certain members of the regulated public may seek a regulation which has the consequence of immunizing a public official from a future enforcement proceeding. The generality of a "reasonably prudent public official" standard argues against providing this result.

As currently drafted, the effect of this regulation would be to provide guidance to public officials as to the legal standard applicable to them when deciding whether or not they may participate in a governmental decision. As discussed, the staff views this, in large part, as mere codification of staff advice.

As to the effect of this regulation in the enforcement context, it is possible that subdivisions (b) (mandatory actions) and (c) (permissive actions) would be used by a public official in an attempt to refute a claim that the official had reason to know, at the time of decision, that he or she had a financial interest in the decision. A public official might offer evidence that prior to participating in the decision, he or she reviewed relevant agency material, undertook the eight-step conflict-of-interest analysis, reviewed relevant Commission publications (such as a fact sheet or prior advice) and concluded, based on that review, that the decision would not have a reasonably foreseeable material financial effect on one or more of the official's economic interests. The official might argue that given this review, his or her conclusion was the product of reasonable diligence and therefore, the official had no reason to know of a financial interest in the decision.

The foregoing illustrates that the draft regulation could have some enforcement implications. However, the primary purpose of the regulation is to codify prior written advice to public officials regarding their duty, in this context, to disqualify themselves from a governmental decision. Subdivisions (b) and (c), on their face, do not purport to be the sole means by which to demonstrate a public official's exercise of reasonable diligence, or the lack thereof. Therefore, the Enforcement Division would not be limited by these subdivisions in pursuing an enforcement matter. Although staff notes this point for Commission's attention, no further discussion or draft regulatory language on this point is provided.

Staff recommendation. On balance, it appears that one way to address the public's request for greater certainty in this area is to codify in a regulation the applicable legal standard. Staff also recommends that reviewing agency material and undertaking the eight-step conflict-of-interest analysis be mandatory elements of a "reasonable diligence" standard. The eight-step analysis is specified in great detail in the Commission's regulations and is an established practice. It is, or should be, ingrained in any conflict-of-interest review conducted by a public official.

Requiring a public official to review his or her agency's material relevant to a governmental decision merely ensures that the eight-step analysis is an informed analysis, entitled to weight. Reviewing the Act and Commission regulations would, in

most instances, ordinarily be undertaken as part of conducting the eight-step analysis. Mandating this review should not unduly burden public officials in these circumstances.

Finally, the Act does not require a public official to obtain a Commission opinion or formal written advice in order to be held in compliance with the conflict-of-interest provisions of the Act. Rather, section 83114 is permissive. Thus, the draft language proposes that seeking a Commission opinion or formal written advice be a permissive way of demonstrating an exercise of reasonable diligence. (Reg. 18700.1(c)(2).)

b. Effect of Third Party Assistance (subdivision (d)). In the mid-1980's through the early 1990's requests for written advice were received in which public officials sought approval of various schemes under which third parties were to be enlisted to ascertain whether the public official had reason to know of a financial interest in a governmental decision. Typically, these were situations in which the economic interest of the official was indirect, that is, based on a spousal ownership interest in a business entity. In those situations the official claimed a lack of actual knowledge of the identity of sources of income to the spouse's business and also claimed that the spouse refused to divulge such identity (usually under a claim of privilege).

In those situations it was proposed that a responsible employee of the spouse's business[13] would review the business's client list and also the agency's agenda materials. If a client was a party, applicant, or named in the agency materials, the employee would inform the public official that a conflict was present with respect to that agenda item and the official would recuse himself or herself from the matter. The written advice generally approved of this third party involvement, but cautioned that use of a third party would not excuse an official from his or her ultimate responsibility to comply with the Act. (I.e., the official relies on the advice of a third party at his or her own risk.)[14]

The manner in which third parties were used to provide assistance varied according to each public official's circumstances. Thus, it is unlikely that any particular methodology captured by a Commission regulation would universally suit the requirements of all officials seeking to employ third-party assistance. Staff, for that reason, has not presented regulatory language to identify one particular methodology as an expression of reasonable diligence. Instead, in subdivision (d) the draft regulation describes one attribute common to any methodology by which a public official could involve third-party assistance; that is, no matter what methodology is employed, *the public official is unable to delegate his or her duty to comply with the conflict-of-interest provisions of sections 87100 and 87103.*

Staff Recommendation: Staff recommends inclusion of subdivision (d).

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[13] In some situations, this review would be conducted by the agency's counsel or the city attorney/county counsel.

[14] See the discussion of the *Price* Advice Letter and its progeny, at pp. 6-8, above.

c. <u>Specific Circumstances (not included in the draft regulation)</u>. A starting point in conducting any analysis of whether a public official has reason to know he or she has a financial interest in a governmental decision is to identify whether any of the official's *economic interests* are implicated in the decision. If a public official's economic interests are implicated in the decision, it is at least possible that the decision will have a reasonably foreseeable material financial effect on those economic interests. (Section 87103 defines a reasonably foreseeable material financial effect on an economic interest as being a "financial interest," within the meaning of section 87100.) On the other hand, if none of the public official's economic interests are implicated in the decision, it would be fair to assume that the decision will have no reasonably foreseeable material financial effect upon the public official's economic interests.

For this reason, it might ease the analytical burden on public officials to assemble a set of specific circumstances under which public officials are deemed to have reason to know that their economic interests are involved in a governmental decision. Based on a review of the Commission's conflict-of-interest regulations and past written advice, four scenarios (below) were discussed by staff. Significantly, even with these specific circumstances, a public official must still take the additional step of determining whether the decision will have a reasonably foreseeable material financial effect on those interests. The result after falling under one of the special circumstances is that a public official is on notice that the official **may** have reason to know that he or she has a financial interest in a governmental decision, without making a definitive determination that the official does, in fact, have reason to know of that financial interest. These are:

- A description or other means of identifying a person or interest in real property which is an economic interest to the official, appears in the agency materials provided to the official in connection with the decision, and the public official knows or has facts providing notice that the person or interest in real property is an economic interest of the official.

- The public official has one or more economic interests directly involved in the governmental decision, within the meaning of 2 Cal. Code Regs. sections 18704(a)(1) and (a)(2) through 18704.2.

- The agency materials provided to the official in connection with the decision include material which, on its face, describes that the decision will financially affect the personal expenses, income, assets, or liabilities of the official or his or her immediate family, as described in 2 Cal. Code Regs., section 18705.5.

- Knowledge that the governmental decision involves an identified person or interest in real property and knowledge that such person or interest in real property is an economic interest of the public official, has either been made available to the general public by the official's agency, is a matter of

> widespread distribution by mass media within the agency's jurisdiction, or is a matter of common knowledge within the agency's jurisdiction.

However, the specific circumstances under which a public official has reason to know that he or she has a *financial interest* involved in a particular decision are vast. For example, whereas some circumstances would serve to inform a public official that he or she might have an *economic interest* involved in a particular decision, those circumstances would not necessarily provide a reason for an official to know that it is reasonably foreseeable that the decision will have a material financial effect on that economic interest.

For example, a public official might have as an economic interest in a company which, as an employer, is a source of income to the official. Assume the company is located in a mixed use residential/retail zoned area. The employer's name might appear in the agency materials which list all retail establishments in that area, in connection with a decision whether to change the lot size for single family homes located in joint residential/commercially zoned area.

The public official's review of the agency materials in connection with that decision would provide the public official with reason to know that he or she has an economic interest (as the employer) involved in the decision. However, merely knowing of this involvement would not, by itself, mean the public official has reason to know whether this decision will have a reasonably foreseeable financial effect on the employer, or whether, assuming the financial effect, it would be of sufficient scale as to be material under the Commission's regulations. Thus, the circumstance of both knowing that the name of the company appears in the agency agenda materials and that the company is an economic interest to the official would not provide an official with reason to know whether any other elements of a financial interest are present with respect to that decision.

The above example illustrates the difficulty in trying to describe, by regulation, circumstances which would allow a public official to definitively conclude that he or she has reason to know whether he or she has a financial interest in a specific governmental decision. Therefore, staff considered regulatory language to describe how "reasonable diligence" is met in the context of Steps 3-6 of the standard conflict-of-interest analysis, but ultimately has abandoned this approach. Staff believes it is too difficult to address every possible situation which can arise. As illustrated above, application of specific rules would be administratively complex and would not capture all of the circumstances in which a public official has reason to know that one or more of his or her economic interests are involved in a governmental decision.

Staff Recommendation: Staff does not recommend the inclusion of specific regulatory language to address how the "reasonable diligence" standard is met in the context of Step 3 of the standard conflict-of-interest analysis.

III. SUMMARY OF STAFF RECOMMENDATIONS[15]

- As a matter of first importance, should the Commission continue with this regulatory undertaking?

Staff recommendation: Yes. However, the Technical Assistance Division notes that it would be helpful if further clarification of the "has reason to know" language in the context of specific facts presented by public officials could be provided at a future date through issuance of Commission opinions.

- The draft regulation at subdivision (a) establishes a legal standard for public officials to follow in determining whether they have "reason at know" of a conflict of interest. Is this an appropriate standard?

Staff Recommendation: Yes.

- Should the standard described in subdivision (a) apply to all of the relevant steps of the conflict-of-interest analysis (Steps 3-6) described in regulation 18700(b)?

Staff Recommendation: Yes.

- The draft regulation, at paragraphs 18700.1(b) and (c), respectively, lists mandatory and permissive criteria which, if followed, would demonstrate that a public official exercised reasonable diligence in deciding whether the official had reason to know of a financial interest in a governmental decision. Are these appropriate criteria?

Staff Recommendation: Yes.

- Should a draft regulation provide that a public official's duty to comply with sections 87100 and 87103 be non-delegable?

Staff Recommendation: Yes.

- Should a regulation instead describe specific circumstances in which a public official will be deemed to have reason to know that the official has a financial interest in a governmental decision of his or her agency?

Staff Recommendation: No.

Attachment: Appendix A - Draft Regulation 18700.1

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[15] The Summary of Staff Recommendations encompass the recommendation of the Legal, Enforcement, and Technical Assistance Divisions.